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February 1, 2021

Statement by Mr. Merk and Mr. Krahnke on Russian Federation
(Preliminary)
Executive Board Meeting
February 3, 2021

We thank staff for its well-written report and Mr. Mozhin for his helpful Buff statement. **We concur with the thrust of the analysis. Against the background of sound budget policy, Russia has retained fiscal space despite a drop in oil prices and the pandemic**. Given the decline in GDP and continued uncertainties, an active use of fiscal space seems warranted. We welcome that some pandemic support measures aiming at promoting job creation have already been introduced, such as the reduction of social contribution of SMEs. The withdrawal of temporary support measures and premature consolidation of the budget should be exercised with caution to avoid derailing the recovery. In particular, prematurely reducing unemployment benefits to pre-March 2020 levels could lead to further loss of purchasing power and lower demand given that real incomes have decreased generally. We support staff's view that further contingency measures should be prepared in case downside risks stemming from the pandemic should materialize. At the same time, we encourage the authorities to adopt further measures with a view to reduce the size of the informal economy and to efficiently target social support measures.

Accommodative monetary policy has supported lending conditions and thereby partially dampened the disinflationary effects of the crisis. We agree with staff that cuts in key policy rates by 2 percentage points in total were appropriate given undershooting inflation as well as the effects of the crisis. Further monetary policy decisions should weigh carefully both potential downward and upward pressures on inflation (including ruble depreciation or increased food prices) and be geared towards strengthening the credibility of the inflation targeting framework in view of its short history. We also encourage the authorities to duly consider that inflation expectations are yet to be firmly anchored to the relatively new inflation target. In this context, it appears to us that overshooting inflation is likely to pose a greater risk than undershooting inflation.

We are encouraged to learn that the banking sector seems adequately capitalized and resilient to the crisis. While regulatory forbearance has enabled loan restructuring, it has also decreased transparency in banks' balance sheets. We thus urge the authorities to closely monitor balance sheets, while phasing-out forbearance gradually when economic developments allow. This would provide more vulnerable banks with time to adjust, for instance by retaining earnings to bolster capital. Banks should also make full use of the resolution framework to expedite the disposal of non-performing loans.

Policies to address structural weaknesses in the Russian economy such as a low diversification of exports, an oversized public sector, suboptimal investment climate, or high inequality should not be neglected in the face of the COVID-19 crisis. We welcome the authorities' initiative to reduce regulatory burdens and red-tape to entrepreneurs. Similarly, the National Projects offer the potential to boost potential growth and catalyze private sector activity. To this end, however, we join staff in highlighting the importance of avoiding a further expansion of the already large footprint of the state in the economy as well as ensuring a level playing field and fair and transparent governance frameworks of the projects concerned. Beyond these two flagship initiatives, we emphasize that efforts to combat corruption and improve legal certainty remain of the essence to improve the business climate.